No. 10594

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

6

WESTERN MESA OIL CORPORATION, etc.,

Appellants,

vs.

EDLOU COMPANY, *et al.*,

Appellees.

APPELLEES' REPLY AS TO NO. 2 AND NO. 4 WELLS.

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TOPICAL INDEX.

TABLE OF AUTHORITIES CITED.

CASES.

STATUTES.

TEXTBOOKS.

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Statement of the Case.

The Appellees herein, being the landowners of that certain property on which No. 2 and No. 4 Wells are situated, make this restatement of facts as follows:

At the time the Debtor Corporation herein filed its petition and submitted its plan of arrangement under Chapter XI of the Bankruptcy Law, it listed total assets of $147,650.00 [R. 10]. Real estate comprised $145,000.00 of this amount, which real estate consisted of the Debtor Corporation's interest in four oil and gas leases [R. 10]. The Debtor Corporation's interest in the No. 2 and No. 4 Wells was valued at $30,000.00 each [R. 20 and 22]. The

leases under which said Debtor Corporation was operating said two wells were community oil and gas leases wherein many landowners participated in the royalties.

The leases as executed by the landowners of said wells contained the usual clauses providing for cancellation of said leases after notice of default for non-payment of royalties [R. 164 and 165]. No notice of forfeiture or of intention to declare a forfeiture had been given by said landowners prior to the filing of Debtor Corporation's petition herein [R. 160 and 165].

On or about March 20, 1942 royalty payments were made by the Debtor Corporation to Bank of America, as depositary for said landowners for royalties due in the month of December, 1941 [R. 215, 216, 217, and 218]. No payments were made subsequent to this time by said Debtor Corporation to said landowners for royalties until the receiver of the Debtor Corporation was duly appointed and had qualified. The receiver paid the current royalties as they fell due from June 19, 1942 until the reorganization was completed [R. 165, 218, 219 and 220].

On June 19, 1942 Debtor Corporation filed its petition in proceedings under Chapter XI of the Bankruptcy Act [R. 2]. The arrangement as contained in Exhibit "A" of said petition stated that the landowners' royalties should be paid prior to the payment of any other debts or obligations from the gross profits derived from the production of the wells [R. 7 and 8].

A Revised Plan of Arrangement was thereafter filed by the Debtor Corporation on December 3, 1942 [R. 77]. Said plan provided that landowners' royalties would be paid in full in the same manner as priority claims, where the facts disclosed that the landowners had not, prior to the filing of Debtor Corporation's petition in bankruptcy, waived their right of forfeiture of the oil and gas leases, either in writing or by their conduct [R. 81].

On December 5, 1942 proofs of claims were filed by said landowners setting forth briefly the facts pertaining to the oil and gas leases and the amount of royalties due them thereunder [R. 223, 231, 235 and 239].

On December 9, 1942 Debtor Corporation filed its petition for the determination of the rights and status of holders of landowners' royalties [R. 51]. Said petition set forth the plan for payment of landowners' royalties as the same had been set forth in the revised plan of arrangement [R. 52 and 53]. Pursuant to such petition, Hon. H. L. Dickson, Referee in Bankruptcy, issued an Order to Show Cause on December 10, 1942 requiring the holders of the landowners' royalties to show cause why the said petition should not be granted [R. 67].

A hearing was held before the Referee [R. 157]. The Referee made an order determining that royalties due the landowners of No. 2 and No. 4 Wells should be paid in full [R. 68].

ARGUMENT.

These appellees adopt the opinion of Judge Beaumont of the United States District Court as their argument in reply to the points advanced by appellants [R. 131]. The question as well as the authorities on which said decision was based were concisely stated therein. The points relied upon by appellants will, however be answered in the order the same appear.

REPLY TO APPELLANTS' POINT NO. I.

The revised plan of arrangement, as submitted by the Debtor Corporation, was approved by the appellants herein prior to the time that said plan was filed in the bankruptcy proceedings. The petition for determination of rights and status of holders of landowners' royalties was filed by the Debtor Corporation and the appellants herein. The plan provided that under certain conditions landowners' royalties would be paid *in the same manner as priority claims* [R. 81] (emphasis supplied). The plan therefore simply provided for the manner in which said claims would be paid. The plan did not attempt to fix the status of the claims according to regular bankruptcy proceedings as being a secured, unsecured or prior claim. The only interpretation that could be given this clause would be that the claims would be paid in full providing the landowners had not waived their right to declare a forfeiture prior to the filing of the petition in bankruptcy. The revised plan of arrangement was accepted by the landowners in this light. It is difficult to understand how the appellants after approving said revised plan of arrangement can now maintain that the Court has no right to make a decree, ordering that the oil royalties should

be paid in full, *i. e.*, in the same manner as priority claims. In the brief submitted by other appellees herein, to-wit, landowners of community Well No. 1, the matter of prior claims under Chapter XI of the Bankruptcy Act is adequately and clearly set forth, and rather than reiterate the law as therein set forth, we refer the Court to the reply to appellants' Point No. 1 in said brief.

The appellants contend that the landowners waived their rights to declare a forfeiture for non-payment of royalties by not giving the Debtor Corporation written notice that it was in default. Many cases are cited holding that such notice is a prerequisite to a successful maintenance of a suit to recover possession or quiet title against a lessee.

These cases do not seem to be in point in so far as they deal with the matter before this court. The notice of default and demand for payment within a certain time is a necessary first step before a complete forfeiture can be declared, but until the right to give this notice is shown to have been waived in writing or by conduct prior to the bankruptcy, the objection and the law cited by appellants do not seem applicable.

There is nothing in the record to show that the landowners of No. 2 and No. 4 Wells by their conduct waived this right.

Waiver is a voluntary abandonment of a known existing right.

> *Connor v. Union Automobile Insurance Co.*, 122 Cal. App. 105.

The landowners of No. 2 and No. 4 Wells had the right each day from March 20, 1942, the date upon which

royalties were paid for December, 1941, to June 19, 1942, the date Debtor Corporation filed its petition under Chapter XI, to give notice of default to Debtor Corporation for non-payment of royalties. The mere failure to give such notice is not, standing alone, a voluntary abandonment of this right.

REPLY TO APPELLANTS' POINTS NO. II AND NO. III.

Appellants contend that the acceptance of royalty payments by the landowners from the receiver of the Debtor Corporation subsequent to June 19, 1942 operated as a waiver of the landowners' right to declare a forfeiture. This contention is directly in conflict with the revised plan of arrangement which provided that any waiver would be based on the conduct of the landowners prior to the filing of the petition by Debtor Corporation under Chapter XI of the Bankruptcy Act. Any actions therefore such as receipt of royalties occurring subsequent to said filing were immaterial to the issue involved herein.

Findings by the Referee herein show that the last check received on behalf of the landowners of No. 2 and No. 4 Wells was dated March 20, 1942, and was for royalties due in December, 1941. The evidence and findings further show that the said landowners did not receive any further payment of royalties until after the Debtor Corporation filed its petition under Chapter XI.

The law in California is to the effect that a covenant for the payment of rent is a continuing covenant.

> *German-American Savings Bank v. Gollmer,* 155 Cal. 683.

The failure of Debtor Corporation to pay the landowners royalties for the months of April, May and the first part of June, 1942, gave to the landowners the right to declare a forfeiture at any time during said period. The failure of the landowners to declare such a forfeiture was not a waiver of their right so to do. The cases are uniform to the effect that receipt of rent after a breach of a continuing covenant does not waive the landowners' right to declare a forfeiture for the breach of a subsequent covenant. The acceptance of royalties on March 20, 1942, therefore did not preclude the landowners from declaring a forfeiture for the breach of the continuing covenant to pay royalties from said date to the time the Debtor Corporation filed its petition under Chapter XI.

Appellants cite *Title Insurance & Trust Co. v. Hisey*, 95 F. (2d) 555. This case refers to *Kern Sunset Oil Co. v. Good Roads Oil Co.*, 214 Cal. 435. The law as cited therein is correct as it pertains to the breach of a covenant to perform a single act, but is not the correct law as to a continuing covenant such as payment of rent. The Supreme Court of the State of California in the case of *Kern Sunset Oil Co. v. Good Roads Oil Co.*, 214 Cal. 435, on pages 442 and 443 of said opinion, said:

> "We confess our inability to draw any distinction in principle between an agreement to construct a building upon leased premises and an agreement to drill a well thereon. Each is a covenant to perform a single act, which act when completed results in the performance of the covenant. On the other hand, the failure to perform said act is a breach of the covenant requiring its performance, and once this breach is waived, the subsequent failure of the tenant to comply with said covenant affords the landlord no right to a

forfeiture of the lease. *It would be otherwise with a continuing covenant like that involved in the case of Myers v. Herskowitz,* 33 Cal. App. 581 (165 Pac. 1031), *relied upon by the plaintiff.* The covenant in the lease considered in the opinion in that case provided that a certain passageway 'shall at all times be kept free and clear' for the 'common purpose of ingress and egress of any and all persons doing business in said room and their patrons.' It will readily be seen that this covenant was not to perform a single act, such as constructing a building or drilling a well, but was to preserve a condition in the leased premises which should continue during the entire life of the lease. On each occasion the tenant failed to maintain said condition, he breached the covenant of the lease. Each breach was separate and distinct from the other, and the waiver of one particular breach would not be a waiver of any breach subsequently occurring." (Emphasis supplied.)

As we have heretofore stated the evidence relative to payments of royalties to the landowners by the Receiver after the Debtor Corporation filed its petition under Chapter XI are not within the issue herein. But even if this evidence is considered, the authorities are to the effect that receipt of rent for current months will not serve as a waiver of the land owners' right to forfeiture for failure of lessees to pay royalties due for prior months.

Vol. 2 *Summers Oil and Gas Law,* Section 448, at page 486;

Duffield v. Michaels, Vol. 97, Fed. page 825;

109 *A. L. R.* 1267, at page 1269.

REPLY TO APPELLANTS' POINT NO. IV.

The Proceeding, Being Under the Provisions of Chapter XI, Dealt Only With Unsecured Claims. The Landowners' Claim Was Classed by the Debtor in the Plan or Arrangement as Entitled to Payment in Full.

The Debtor Corporation had a right under Sections 356 and 357 of the Act to propose that the landowners' claims should be paid in full. The revised plan or arrangement including the clauses relating to pay of landowners' royalties in the same manner as prior claims was filed with the Referee on December 3, 1942. The landowners, on December 5, 1942, filed their claims wherein was set forth facts pertaining to the oil and gas leases and the royalties due thereunder. The claim was filed on the theory that the revised plan of arrangement had set forth in full the manner in which said royalties would be paid, and the landowners needed some vehicle for the court record to show the amount of monies owing to them. This was not a claim filed in regular bankruptcy proceedings but merely a statement of claim filed with the court pursuant to the revised plan of arrangement. This being the case the landowners did not waive their right to be paid in the same manner as prior claimants.

REPLY TO APPELLANTS' POINT NO. VI.

Appellants' contention that the District Court erred in determining the rights of the landowners only from their acts and conduct prior to the commencement of the bankruptcy proceedings is not well founded. Appellants state that pleadings in bankruptcy are informal and that the niceties are not to be expected in bankruptcy pleadings. The revised plan of arrangement is in the nature of a

contract wherein property rights are to be settled. The landowners had the right to accept or reject said plan. In the acceptance of the plan by the landowners they relied upon the manner for payment of the royalties as set forth therein, *i. e.*, conduct or landowners prior to the filing of debtor's petition under Section XI. If under the plan the conduct of the landowners both before and after the filing of debtor's petition was to be considered a statement to that effect should have been included in the plan.

Appellants contend that the clause in the revised plan of arrangement providing for the determination by the Court of any controversy that might arise as to the proper status of claims of holders of landowners' royalties means that the Court could consider the conduct of said landowners subsequent to the filing of Debtor Corporation's petition in bankruptcy. This contention in our opinion is erroneous. The proper interpretation of said clause is that the Court should determine any controversy as to the status of said royalty claims by reason of the conduct of said landowners prior to the filing of said bankruptcy petition. In other words, if the landowners and Debtor Corporation could not determine this matter amicably then the Court would make said determination.

The plan was approved by the Referee on December 17, 1942 [R. 100]. Immediately after the plan was approved the controversy herein was tried before the Referee. The language as used in the plan was clear. The findings of the Referee and the opinion of the United States District Court interpreting said language was correct in all respects.

Conclusion.

The landowners of No. 2 and No. 4 Wells did not waive their right of forfeiture of the leases prior to the filing of the petition in bankruptcy by Debtor Corporation for the reason that they did not receive any royalty payments from March 20, 1942, until subsequent to the filing of said petition. During said period said landowners had the right at any time to declare a forfeiture of the lease for non-payment of royalties by giving notice pursuant to the terms of said leases. We therefore submit that the order of the United States District Court should be affirmed.

Respectfully submitted,

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